

ELM Solutions

LegalVIEW® Insights

Volume 3: The Effect of Very Large Legal Matters on Outside Legal Costs



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Volatility in Outside Counsel Spend: Containing the Chaos

In Q2 2021, Wolters Kluwer's ELM Solutions published the second installment of its LegalVIEW Insights series of reports based on research out of LegalVIEW, the world's largest body of legal performance data. That report showed that outside spend in corporate law departments is fairly volatile, with 29% of corporate legal departments (CLDs) experiencing a 90% swing up or down over a five-year period, and many of the rest experiencing a lesser—but still significant—amount of volatility. The volatile aspect of outside counsel spend suggests it is not necessarily predictable based on data from the last couple years, creating problems for CLDs tasked with establishing meaningful departmental budgets and adhering to them. In fact, the volatility suggests some CLDs are in a position of accountability without control—they are accountable for staying within budget and have a number of levers they can pull, but none of that hard work guarantees against an unexpected spike in demand that causes the department to go overbudget. As one legal ops director remarked when presented with the data, "Sometimes you look like a genius, sometimes you look like an idiot—but you're probably neither."

The Q3 LegalVIEW Insights report follows up on that research by asking the questions: Why, where, and what? Why does legal spend go up and down so much, and where is that volatility coming from? Just as importantly, what can corporate law departments do differently based on the answers to the prior two questions?

The research suggests that changes in the number and size of very large legal matters—in this report, we will call them "megamatters" and define them as any matter having greater than \$1M in lifetime spend—drive a lot of the volatility seen in total outside spend. Consider the following:

- In the typical corporate law department, matters with over \$1M in lifetime spend account for about 61% of total outside counsel spend in any given year.
- Total outside counsel spend is extremely sensitive to changes in megamatter spend. For instance, if total spend on matters greater than \$1M in lifetime spend goes up by even \$1 in a given year, that creates an 89% chance that total spend overall will go up as well. Thus, changes in total legal spend tend to be driven by megamatters moreso than other matters.

- Over a six-year period, over one-third of CLDs will spend double on megamatters in a “bad year” compared to what they will spend on them in a “good year.” Almost 9% of organizations will spend six times more in a bad year than in a good.
- In a typical corporate law department, somewhere between 2.5 and 5% of legal matters generate 80% of legal spend in any given year. The other 95 to 97.5% of matters together represent only about 20% of total spend, begging the question of how much attention they really deserve when that attention could instead be refocused on megamatters.
- Litigation matters with greater than \$1M lifetime spend account for about 32% of all legal spend, indicating they may be a good target for ensuring legal project management, a thoughtful approach to eDiscovery, and other essentials are in place.

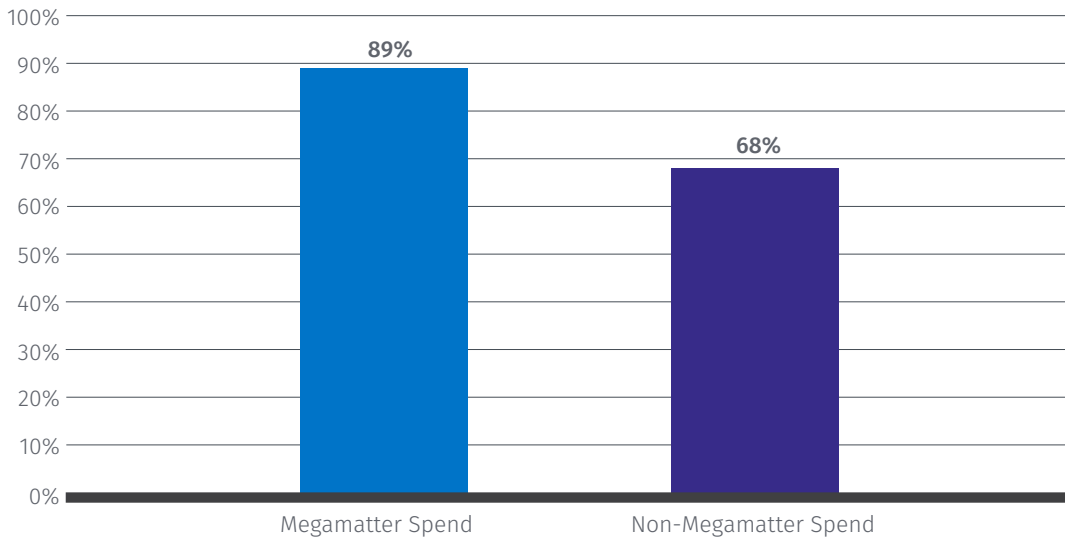
Below are the specific insights with more detailed analysis.

Insight #1

Megamatters all but dictate the direction of total legal spend.

Megamatters are bellwethers for how total spend will go. To some extent, this is to be expected because megamatters account for 61% of spend, but the volatility of megamatters means they drive changes in total spend even more than their 61% would suggest. Figure 1 below shows that legal spend is so sensitive to changes in megamatter spend that if spend across megamatters goes up or down in a given year by any amount—even \$1—there is an 89% chance that total outside counsel spend will go up or down in the same direction. In contrast, there is only a 68% chance that, if non-megamatter spend changes in one direction, total legal spend will change in the same direction.

Figure 1: PCT Likelihood that Total Departmental Spend Will Change in the Same Direction As Megamatter Spend vs. Non-Megamatter Spend

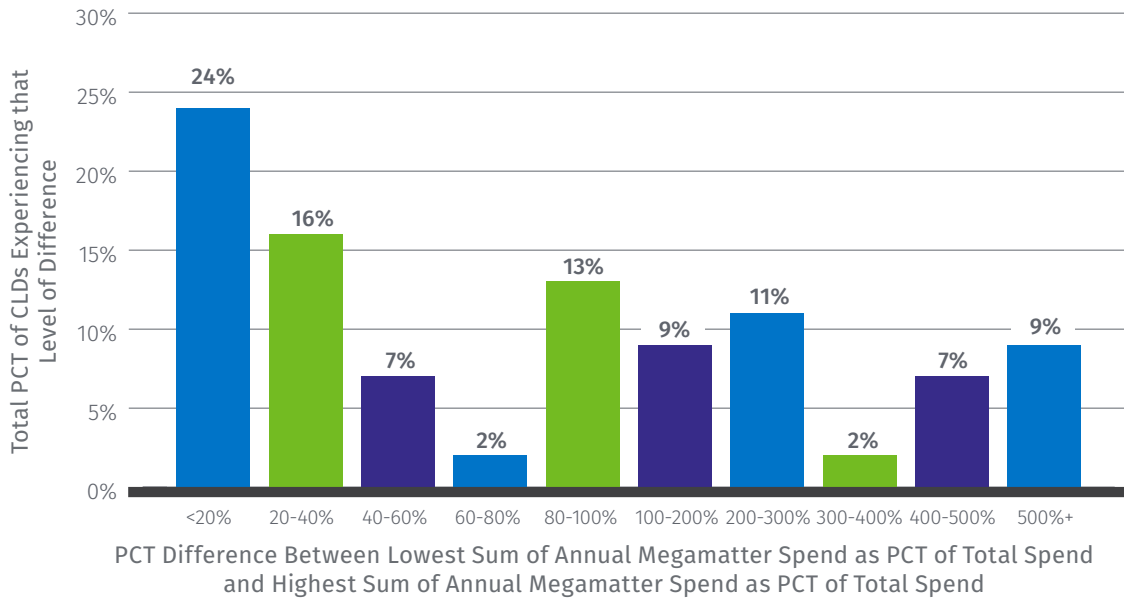


Insight #2

Megamatters are volatile.

In a significant number of CLDs, the percentage of outside spend represented by megamatters will range from very low to very high over a six-year period. For example, in 38% of CLDs, megamatters as a percentage of overall outside spend in a high year will be at least double what they were in a low year, all the way up to 6x or even more in some cases (see Figure 2). This suggests that megamatters account for a lot of the volatility in outside counsel spend that is the bane of legal ops existence.

Figure 2: Six-Year PCT Variation in Megamatter Spend as PCT of Total Spend (2015-2020)



There is a lot of volatility not only in the amount of spend represented by megamatters but also by the number of megamatters as a percent of total matters. In 27% of CLDs, the number of megamatters as a percentage of total ongoing matters will go up or down by 100% over a six-year period and can even go up or down by 6x in 2.2% of CLDs (see Figure 3).

Figure 3: Six-Year PCT Variation in Megamatter Count (2015-2020)

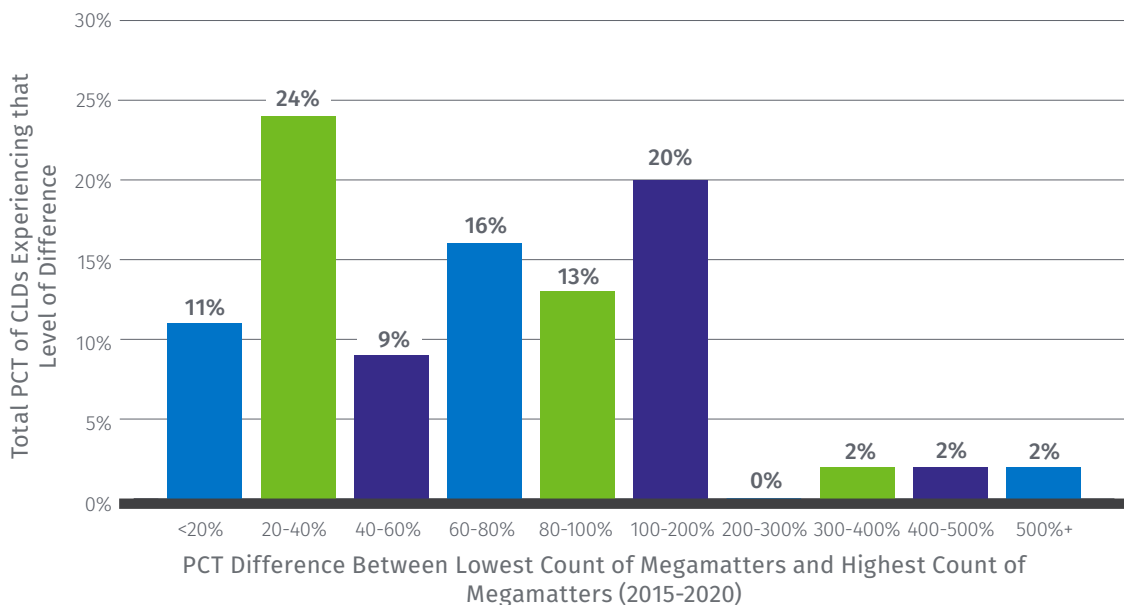
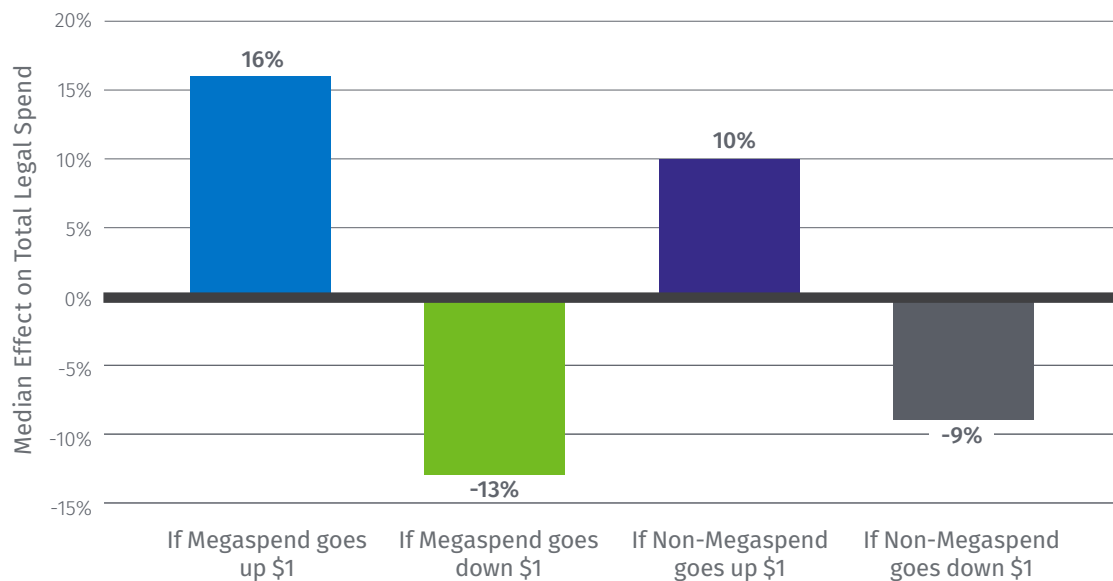


Figure 4 below further supports the idea that megamatters are the ones more responsible for fluctuations in outside spend. When megamatter spend goes up or down by \$1, the median impact on outside counsel spend is a +16% increase, whereas the median impact on outside counsel spend when the sum of spend for non-megamatters goes up is 10%. The difference between 16% and 10% might not sound big at first glance, but a law department that sees consistent 16% growth in total spend will be paying double at the end of 14 years what it would have paid if the increase was only 10%. Law departments that truly care about cost control cannot afford to ignore the long-term impact of decisions that may not seem as significant when only the short-term is considered.

Figure 4: Magnitude of Effect on Total Legal Spend In Four Different Situations (Median)



The fluctuations not only in the size but also the number of megamatters and the connection between megamatters and total spend draw attention to the importance of communication within a CLD between practice group managers, business unit leaders, law firms, and legal ops during the departmental budgeting process. Megamatters come and go, and some are quickly replaced with still larger megamatters, while others are not replaced at all. Unless legal ops has a complete list of what new megamatters are likely to emerge, as well as a list of all existing megamatters and their likely spend in the coming fiscal year, the law department budget will be developed blindly and have a low probability of being adhered to. Legal ops directors know this and try to account for it by having good lines of communication with practice group managers, but the process is usually informal and can even be somewhat of an afterthought in a budgeting process that is sometimes messy and bureaucratic. Furthermore, even where legal ops has established clear lines of communication with practice group managers, there is no assurance that the practice group managers themselves know about each and every new megamatter coming down the pike. Deals and potential deals aren't always immediately communicated to them, and certainly disputes that could erupt into major litigation but haven't yet create risks that arguably should be priced into the budget but almost certainly aren't. Cost containment/managing the budget consistently sits at the top of priorities for legal ops,¹ but if the wrong surprise megamatter comes in, it guarantees going overbudget, no matter how mature the legal ops function. Some law departments might benefit from a more thoughtful approach that carefully documents existing and anticipated megamatters, as well as a risk-based model for pricing in surprise matters—some of which will inevitably occur some of the time. A budgeting process that assumes no surprises isn't a budgeting process at all—it is wishful thinking.

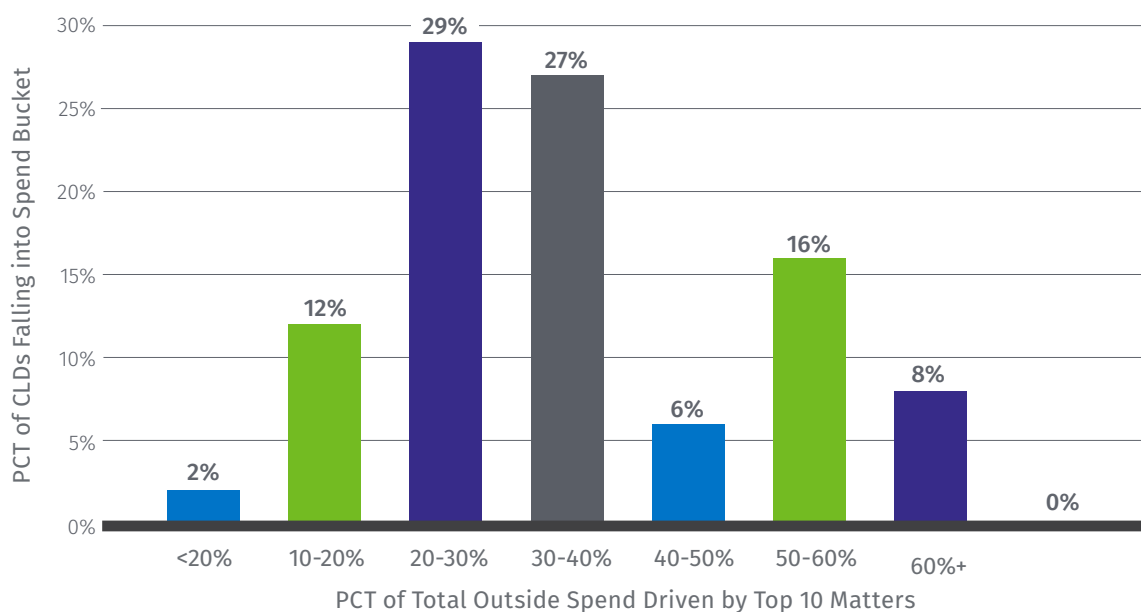
¹ Blickstein Group 2019 Law Department Operations Survey, p. 12.

Insight #3

Not all megamatters are created equal, and some may require a low-maintenance approach—but not too low-maintenance.

In 56% of law departments, the largest legal matters—the top 10 legal matters—represent between 20 and 40% of spend, more frequently at the lower end (see Figure 5, below).

Figure 5: Percentage of Total Outside Spend Driven by Top 10 Legal Matters



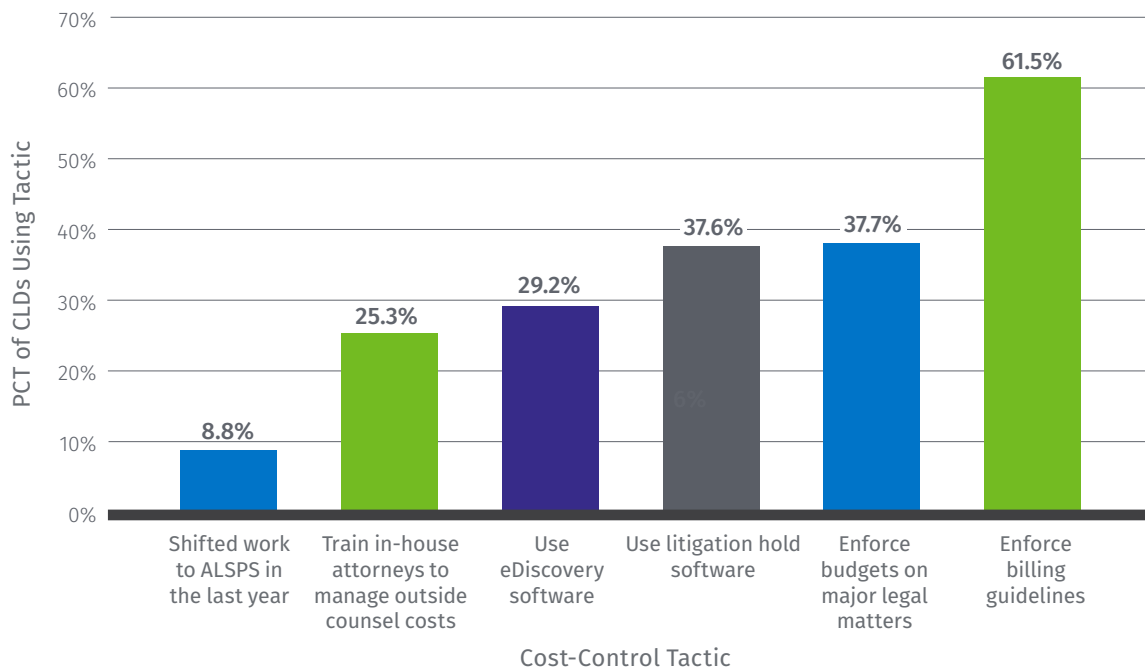
This is potentially a huge opportunity for cost savings because there is always low-hanging fruit in every type of legal matter, and the scale of these matters means that the simple effort of picking the low-hanging fruit from a single matter could save millions. The biggest opportunities for savings are in the largest matters, but those can also be the matters where the organization is most likely to choose a hands-off approach because the matters are so high stakes (and potentially urgent) that the corporation will pay any cost. Nevertheless, those matters are so large and so significant to total spend that it begs the question of whether there are minimally invasive ways to save money on these matters without introducing any risk of impacting the speed or quality of the legal work. Furthermore, even if it is admitted that there are some legal matters that are so sensitive they must be ignored by legal ops entirely, most megamatters are probably not quite that important, and legal ops should be able to find ways to contribute without creating any undue friction.

Figure 6 shows some of the key cost containment measures from a survey by Altman Weil - also consider the following:

- Only 37.6% of CLDs use litigation hold software, even though 76.2% of CLDs say it creates a significant improvement in efficiency² and can limit the risk of expensive downstream discovery disputes, including arguments over defensibility.
- Only 29.2% of CLDs use eDiscovery software, even though 87.7% say it creates a significant improvement in efficiency.³ Only about 30.3% of CLDs use ALSPs for eDiscovery, the rest relying on a mix of insourced work and law firms.⁴
- Although 82.5% of CLDs require budgets on major legal matters,⁵ only 37.7% enforce those budgets, despite the fact that 76.1% say such enforcement results in “significant improvement in cost control.”

- Only 8.8% of CLDs shifted work to ALSPs and other non-law firm vendors over a 12-month period,⁶ despite the fact that 94.7% said it resulted in a significant improvement in cost control. Overall, LegalVIEW data indicates ALSPs account for only about 2.2% of spend on megamatters, many of which contain large eDiscovery and due diligence portions that are the exact kind of process work where ALSPs are strongest.
- Only about 15% of legal spend is subject to AFAs, and the most common types of AFAs are fixed-fee per matter or for a portfolio of like matters—not kinds of AFAs associated with megamatters.⁷ While leading CLDs have had success managing megamatters using other types of AFAs, such as flat fee by matter stage, whole, or partial contingency, the vast majority of CLDs have little to no experience with those kinds of arrangements.⁸ All of this suggests AFAs are used most frequently on smaller, relatively fungible matters that this analysis has suggested are not the primary driver of legal spend or, more importantly, volatility.
- Only about 47% of CLDs use competitive bidding or RFPs.⁹
- Only about 25.3% of CLDs train in-house attorneys to manage and enforce outside counsel costs and budgets,¹⁰ which virtually guarantees that some of the involved tasks are done inconsistently or not at all,
- Approximately 38.5% of all CLDs either do not have billing guidelines or do not enforce what guidelines there are.¹¹

Figure 6: CLD Use of Cost-Control Tactics¹²



The above measures are all suited to controlling the costs of large legal matters, even though many of them can be used to manage costs in smaller matters as well. Why are they not used more frequently on megamatters, where there are the most dollars to be saved?

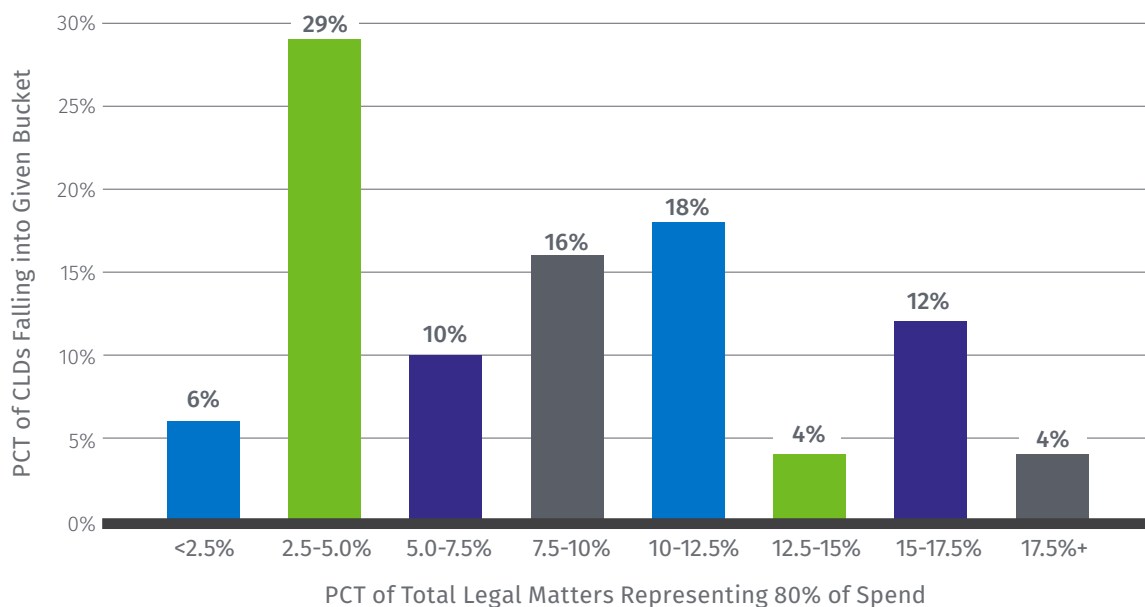
First, some CLDs lack business maturity and/or the opportunity to scale whatever maturity they have. 27% of CLDs do not have full-time legal ops.¹³ Part of these organizations will eventually mature, adopt legal ops, and then adopt many if not most of the tactics described above. But some percentage will not have the volume or consistency of, say, litigation work to justify a significant up-front investment in people, process, and technology aimed at reducing litigation costs. It doesn't make sense to invest a lot of time, money, and effort into creating an end-to-end eDiscovery program if litigation activity is minimal or intermittent at your company.

But one other reason why megamatters do not get the full legal ops treatment is because of the attitude, “keep your hands off my matter.” If the people working in legal ops or the concept of legal ops itself has not gained full credibility within an organization, some in-house attorneys seem to worry that, while budgeting and legal project management may be fine for lesser legal matters, legal ops should take a more or less hands-off attitude towards true bet-the-company cases. These cases are just too risky, the argument goes, and therefore the risk of introducing any best practices at all is unacceptable.

Many legal ops professionals seem to agree that there are certain cases where the amount of money at stake is so large and the situation so delicate that, for instance, moving eDiscovery work to an ALSP would be inappropriate. The urgency behind some of these matters also means there is a push to just get to work, and time-consuming tasks like thorough matter scoping, negotiating phase-based matter budgets and AFAs, and creating clear goals and accountability structures can fall by the wayside. The important thing is to get straight to it and minimize administrative details, which are a hindrance to the actual legal work.

There is some truth to these arguments, but they do not apply equally to all types of megamatters. [Figure 7](#) shows that, in the typical law department, somewhere between 2.5 and 5% of legal matters sum up to 80% of outside counsel spend. Not all of those are necessarily megamatters, but most of them are, and certainly the most expensive of them are. If any serious cost savings are to be had, legal ops cannot focus much time on the 95 to 97.5% of legal matters that only amount to 20% of spend. They are forced to tackle large legal matters, perhaps even some of the largest matters, albeit in a mature fashion that tailors the implementation of best practices in a way calculated to create as little friction as possible with the performance of actual legal work. Creating matter-specific discounted rates for megamatters and enforcing billing guidelines, for instance, are low-touch tactics done in many large, sophisticated CLDs for years without any apparent detrimental effect on quality. The closer CLDs look at megamatters, the more similar low-hanging fruit CLDs are likely to find in terms of opportunities for cost savings. While there are plenty of reasons to avoid overly mechanical and/or intrusive approaches to managing large legal matters—many of which are indeed unpredictable and “too complicated to manage” in some ways—to not pick the low-touch, low-hanging fruit is simply to leave money on the table.

Figure 7: PCT of Total Legal Matters in a CLD Representing 80% of Total Legal Spend



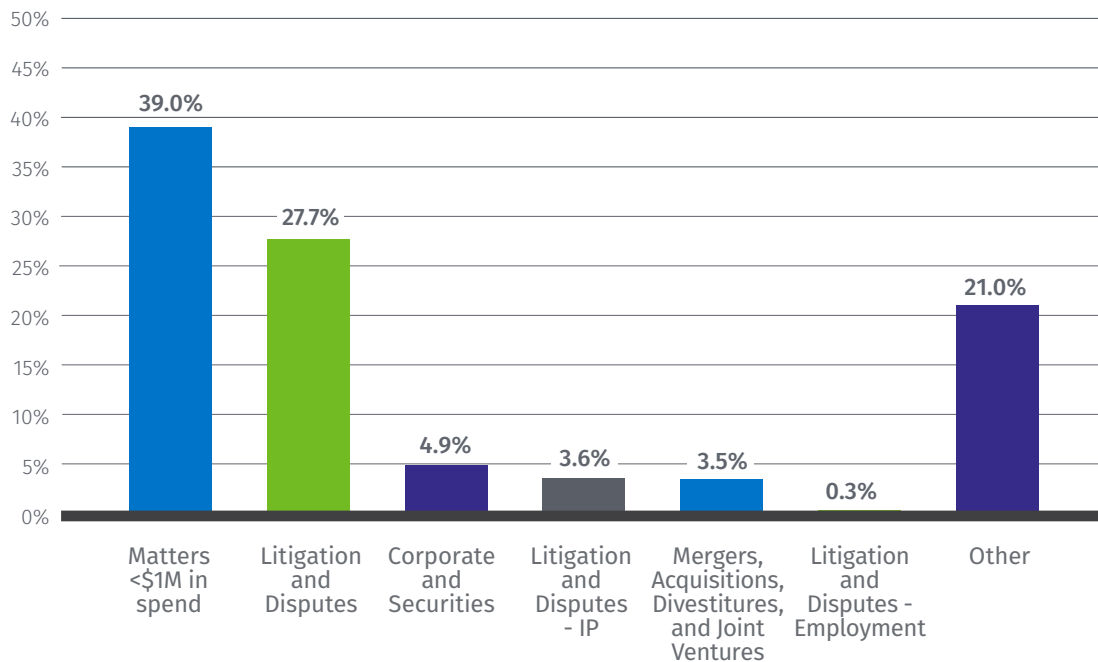
Insight #4

The vast majority of megamatter spend falls into a handful of matter types, which call for different solutions.

As seen below in [Figure 8](#), litigation megamatters represent about 27.7% of total legal spend. When adding in IP litigation and labor employment litigation, the number comes out to about 31.6% of all legal spend. Following litigation of various sorts, the most common megamatters include corporate and securities matters and M&A at 4.9% and 3.5% of total legal spend, respectively—very significant but dwarfed by litigation spend.

These three megamatter types—litigation, corporate and securities, and M&A megamatters—together represent almost 40% of spend and are each big enough to justify investments to streamline those processes. The extensive investment the industry has already made in eDiscovery is just one example; in the M&A world, elaborate transaction management tools and tools to automate parts of the closing process are becoming more and more common, and about 13.6% of CLDs use ALSPs for some part of the due diligence process.¹⁴ A thorough discussion of ways to save money in specific types of legal matters is beyond the scope of this analysis, but the amount of spend in question is significant enough that legal ops directors should educate themselves about the challenges and best practices for addressing these matter types. Megamatters of these types will not go away but will tend to recur in most organizations year after year, meaning that investments in people, process, and technology can continue to pay dividends indefinitely. In contrast, less common kinds of megamatters like bankruptcy, although certainly important, are probably not as consistent year over year and therefore don't really justify investment in a long-term solution.

Figure 8: Percentage of Total Corporate Legal Spend Broken Down by Megamatter Type
Megamatter = Legal Matter >\$1M in Lifetime Spend



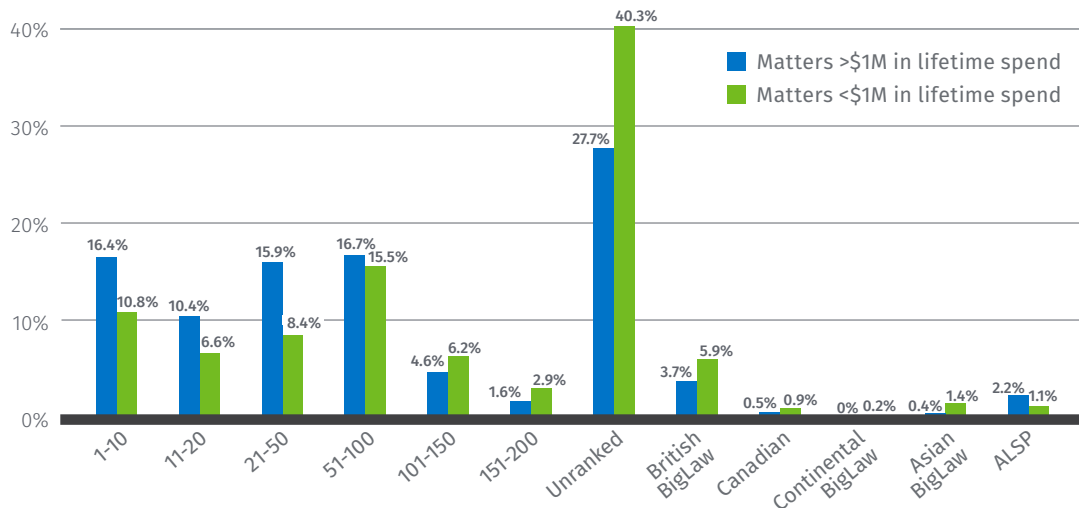
¹⁴ Blickstein Group 2019 Law Department Operations Survey, p. 12.

Insight #5

It's not just the largest firms that matter.

The stereotype might be that the largest law firms dominate the largest, most important legal matters with the most spend. Figure 9 below shows that that tends to be the case, but unranked law firms outside the Am Law 200 still play a significant role, together accounting for about 28% of spend. This is less than the 40.3% of spend they capture among matters less than \$1M in lifetime spend but still more than some observers would expect.

Figure 9: Difference in Market Share Between Matters >\$1M in Lifetime Spend vs. <\$1M Broken Down by Provider Tier



The use of unranked firms in significant legal matters raises at least two questions: 1. Why are they used so commonly in matters that are, by some accounts, so sensitive that they can only be entrusted to the largest, most prestigious firms; 2. Since it is apparently, at least according to the CLDs who continue to use them, safe enough to use unranked firms for some megamatter work, is there an opportunity to use them even more broadly and thereby capture cost savings in the form of lower hourly rates?

On the first question, there are at least two reasons why some of these smaller, “regional” or even smaller firms retain as much market share as they have. First, the geographic nature of the work. Litigation cannot happen at large, only in a particular court in a particular geographic location. A lawsuit over oil and gas rights in Cheyenne, Wyoming, for instance, might have to happen in the state of Wyoming. Many of the large law firms CLDs are used to dealing with, however, aren’t going to have a Wyoming office, won’t know the local court rules, and won’t understand the personalities and expectations of the judges. Regional firms in nonmetropolitan areas like Wyoming—which have strong connections to the geography and knowledge of local practice—have a unique selling proposition here. This is one reason why they continue to maintain a significant market share in megamatters and particularly in litigation megamatters, where they do even better than in megamatters in general (see [Insight #6](#), below).

The other reason why smaller firms are used in some megamatters may have to do with the local nature of personal connections. A CLD at a midsize bank headquartered in Kansas City, for instance, may feel comfortable using an unranked but reputable firm in Kansas City to do certain types of legal work that attorneys in another CLD at a midsize bank headquartered in Manhattan wouldn’t dream of sending to anyone outside the Am Law 100. The in-house attorneys in the Kansas City example know, like, and trust their personal connections and although the unranked firm may be little-known outside of Kansas City, in the Kansas City area itself, it is very well-known and trusted.

However, if a midsize bank in Kansas City hires a Kansas City firm to do a particular type of megamatter, the firm does the work competently, and the client is satisfied, that raises the question of whether the Kansas City firm could have satisfied the Manhattan client equally well. Is the Manhattan CLD really paying

for quality, or are they paying for prestige? Many of the leading thinkers in the legal profession – including Bill Henderson, Mark Cohen, Jens Nasstrom, Evan Parker, Marjorie Shultz, and Sheldon Zedeck – question whether there is as much of a relationship between prestige and quality as law firms would have their clients believe.¹⁵ CLDs that fail to at least consider using regional firms in some megamatters may be missing significant savings in the form of reduced rates. Although megamatters are certainly important, they are mostly not true bet-the-company matters, and a lot of the work could be done competently by a wide range of providers.

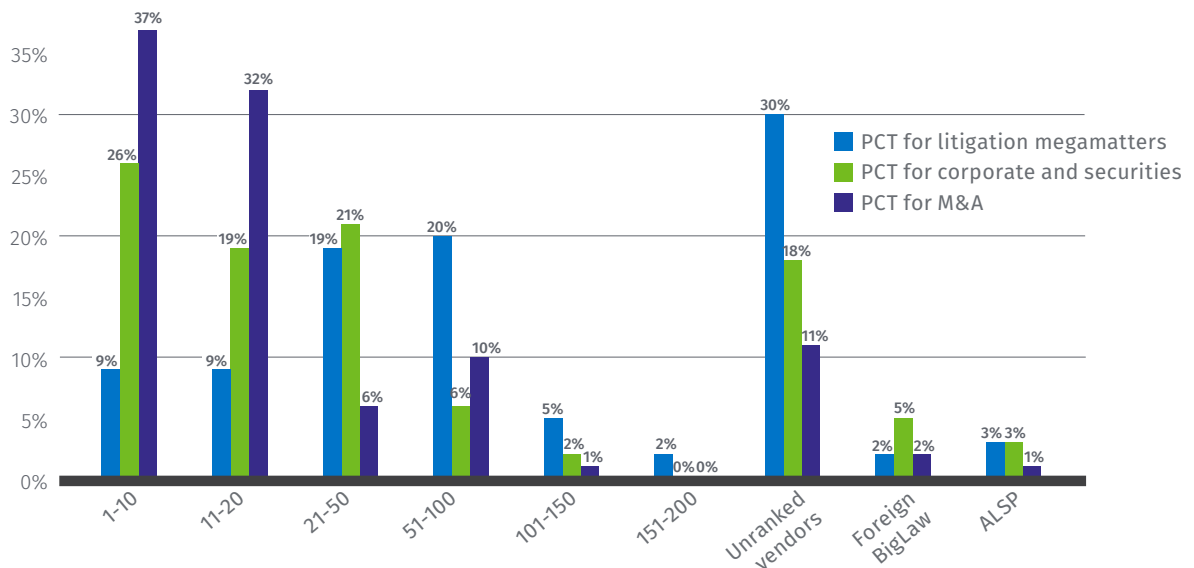
But there are reasons some CLDs eschew regional firms besides paying for prestige. Large firms offer institutional advantages that go beyond whatever advantages they have in the form of lawyer talent. Large firms offer broader geographic and practice area coverage, and global firms work literally around the clock on the problems of their clients. The sheer diversity of legal problems they can address allows clients to send more work to them, which in turns allows for negotiation of more favorable rates and even large volume discounts. In some litigation situations, the right large firm can play an intimidation role that discourages the opposing party from playing games or pushing too hard in settlement negotiations. Larger firms also have the scale to invest more in cybersecurity to protect client data and enjoy other institutional advantages that help explain a level of revenue growth that most smaller firms cannot match.¹⁶

Insight #6

Although unranked firms play a significant role, they take a back seat to the largest firms on “white shoe” work.

The involvement of unranked firms tends to diminish in more prestigious types of megamatters, including M&A and corporate/securities work. The very prestigious Am Law 10 and 20 firms dominate this work, with the top 20 firms taking almost 70% of all M&A megamatter fees (see Figure 10, below). Even firms in the 20-50 range struggle, getting 59% less of the M&A megamatter market than the share they achieve in megamatters in general. Firms outside the Am Law 20 tend to derive a greater portion of their megamatter revenue from litigation than other sources. While the amount of litigation done by the Am Law 20 is by no means insignificant, their business is clearly less litigation-focused and more corporate and transactional in nature.

Figure 10: Difference in Vendor Mix Between Different Types of Megamatters



¹⁵ “BigLaw – Does prestige equal quality? Does it have to?” Nathan Cemenska, legaltechnology.com, September 6, 2021. Available at: <https://legaltechnology.com/comment-biglaw-does-prestige-equal-quality-does-it-have-to/>

¹⁶ For discussion read, “Is the legal industry about personal relationships for B2B relationships? We’re about to find out,” Nathan Cemenska, legaltechnology.com, July 5, 2021.

Without more data, it is hard to say whether megamatters are being sourced to optimal vendor tiers. However, some CLDs have noticed a tendency of some in-house counsel to hire bet-the-company firms for cases that are not truly bet-the-company and have created processes that guide in-house counsel to more affordable tiers of vendor when appropriate.¹⁷ If they look themselves in the mirror, many CLDs may find similar opportunities for savings.

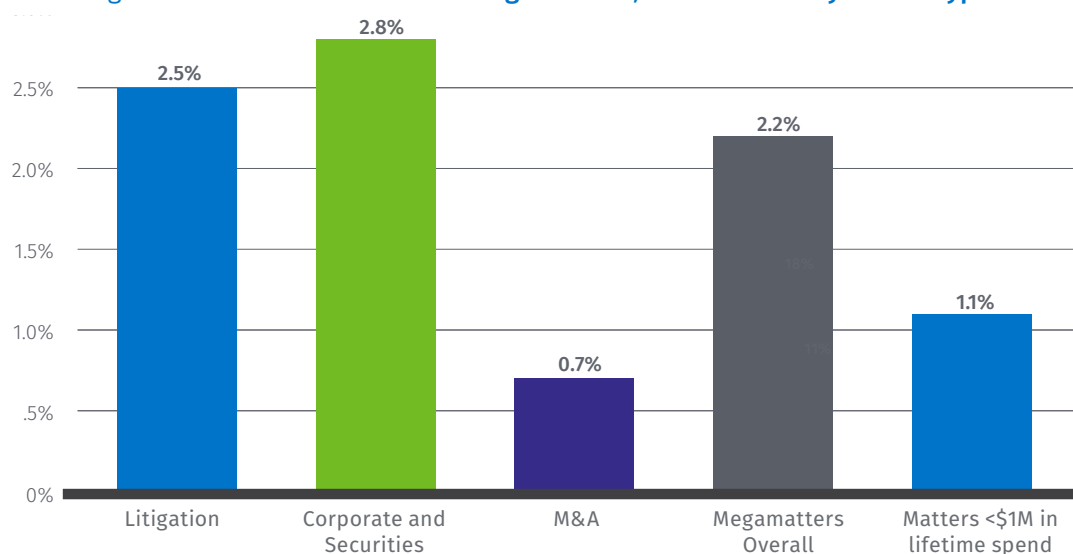
Insight #7

ALSPs are used about twice as much in megamatters as they are in the non-megamatters.

ALSPs may be better suited to larger matters than to smaller ones. A small litigation matter, for instance, might require only minimal eDiscovery, making it affordable for the law firm that is doing the rest of the work to do the eDiscovery as well—better to just get the matter over with. That argument goes away in a \$20M litigation matter that lasts seven years, as the savings from the ALSP engagement will continue to pay much bigger dividends over a much longer period of time. CLDs that experience a critical mass of consistent megamatters, and particularly litigation, in some sense may be forced by that litigation to eventually start using ALSPs. The economics are just too good to ignore.

Despite their cost-effectiveness, ALSPs have captured only a very small portion of the legal market (see Figure 11). However, they have captured about double the market in megamatter work (2.2%) than they have in the market for smaller matters (1.1%). Furthermore, ALSP involvement is not distributed equally across all types of megamatters but is elevated in litigation (2.5%) and especially corporate and securities work (2.8%). The minimal role ALSPs play in M&A work—which includes a lot of due diligence process work that seems suited to ALSPs—may be at least in part to the white shoe culture around that type of work and the tradition of having most of that work be done only by the largest, most prestigious firms.

Figure 11: ALSP Share of Outside Legal Market, Broken Down by Matter Type



¹⁷ See Nathan Cemenska, “How to Build a Smarter Sourcing Strategy,” Legaltech news, April 8, 2021, available at: <https://www.law.com/legaltechnews/2021/04/08/how-to-build-a-smarter-sourcing-strategy/>

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